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## Influence of Institutional Business Factors on the Growth of Social Enterprises in Croatia

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### Abstract

Social entrepreneurship is recognized as a key element in overcoming social and economic problems. The impact of social enterprise is recognized in balanced use and allocation of available resources, reducing unemployment, strengthening of democracy, reduction of the informal economy, encouraging social cohesion and improving the quality of life. Social entrepreneurship in Croatia is faintly developed and it is necessary to get financial injection by the government to support the development and expansion of companies in the sphere of social entrepreneurship. In Croatia, there is still a missing institutional framework to support the operation and development of social enterprises. The main reasons for this are the lack of definition of the legal framework, but also a wide interpretation and understanding of the concepts of social entrepreneurship and social enterprise, both in theory and in practice. In order to see which institutional business factors influence on the growth of social enterprises, the data was conducted with primary and secondary research.

**Keywords:** funding; local communities; public sector; social entrepreneurship; social entrepreneurs; social enterprises; social enterprises growth.

### 1. Introduction

Social entrepreneurs have limited resources so cooperation with the public sector and local community has enormous importance in the approach and the mobilization of funds from different sources.

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Financial support has been identified as a major obstacle for the further development of social enterprises [1]. Social entrepreneurs must make up for limited funding for recruitment, retention, and motivation of different stakeholders [2]. Public sector and local communities can play an important role supplying "influential" or encouraging shareholders capital investments [3]. Social entrepreneurs and their ventures are faced with new challenges and changes relating to the method of financing their projects [4]. Rising costs, fewer donations and grants as well as increasing competition in the social sector are factors that concern social entrepreneurs [4].

## **2. Social entrepreneurship, social entrepreneurs and social enterprises**

The concept of social entrepreneurship was defined by Bill Drayton 1972 and according to him, social entrepreneurship represents an innovative approach of an individual who solves a social problem that is affecting his community. According to Fowler [5] social entrepreneurship is a process of creating viable economic structures and relations between various institutions and organizations that yield and sustain social benefits. According to [6], social entrepreneurship is defined as the specific behavior of entrepreneurs who work for social purposes and not for profit and personal aims. According to [7] entrepreneurship represents a multi-dimensional discipline based on the areas of economics, strategic management, psychology, and sociology. Reference [8] also define social entrepreneurship as a multi-dimensional specific behavior of entrepreneurs who certain characteristics that are necessary to achieve social benefits. According to [9] characteristics that an individual must have are innovation, proactiveness and risk taking. Social entrepreneurship as a newer branch of entrepreneurship is described by [10] and [11]. Reference [10] describes social entrepreneurship as the work of community and voluntary organizations that aim to achieve social benefits. Social entrepreneurship is a new branch of entrepreneurship that connects the private and social sector and represents an innovative model to provide products and services that political or economic institutions are not able to provide society [11]. Social entrepreneurship as innovation is defined by [2,12]. According to these scientists, social entrepreneurship is an innovation [2] and a combination of resources with the aim to create and sustain social benefits [12]. Reference [13] describes social entrepreneurship through three approaches. The first approach is to identify what motivates stakeholders to create social value, the second approach is to define social entrepreneurship through the outcomes, while the third approach is to define social entrepreneurs by the kinds of organizations they run.

Social entrepreneurship is characterized by three components:

- Identifies stable, but inherently unjust equilibrium that causes marginalization or suffering of a segment of the humanity that lacks the financial means or political clout to achieve changes for themselves.
- Identifies opportunities and develops socially entrepreneurial ventures, using inspiration, creativity, readiness for action and challenging the stable state's hegemony and
- Creates a new, stable equilibrium that releases the suffering of target groups, through the creation of a balanced system, thereby ensuring a better future for the target group and even society [14].

Social entrepreneurship defined through the individual is described by [15]. According to them, social entrepreneurship is considered when individual aims to create social value, shows the ability to recognize and takes advantage of opportunities to create that value.

## 2.1 Social entrepreneur

The role of social entrepreneurs is working on existing social problems, providing innovative solutions to mitigate the problems that exist [16]. Joseph Schumpeter described the social entrepreneur as an agent of change who combines vision with creativity and has a strong ethical responsibility [17]. But according to some authors, the role of social entrepreneur as an individual whose aim is to create social value is not acceptable because the creation of economic value also has a strong impact on the maintenance of innovation [18]. Skoll Foundation describes social entrepreneurs as individuals who are motivated by altruism and a deep desire to promote the equal civil societies that are innovative. Reference [19] notes that innovative social venture cannot achieve full potential as long as there is no comprehensive understanding of how they operate and what assumptions motivate them [20]. According to [11] social entrepreneur means a person who possesses special qualities and high ethnicity [20].

**Table 1:** Definitions of social entrepreneurs

Source	Definition	Main features
Bornstein (1998, 2004)[21]	Social entrepreneur combining entrepreneurial skills with a passion for social responsibility.	<ul style="list-style-type: none"> <li>• Persistence</li> <li>• Mission leader</li> </ul>
Thompson and his colleagues (2000) [22]	Social entrepreneurs are people who realize where there is an opportunity to satisfy some unmet needs and who gather to make a change in society.	<ul style="list-style-type: none"> <li>• Emotionally charged</li> <li>• Social value creator</li> </ul>
Dees (1988, 2001) [23,24]	Social entrepreneurs are people who: <ul style="list-style-type: none"> <li>• Create and sustain social value</li> <li>• Recognizing and relentlessly pursuing new opportunities to serve mission</li> <li>• Exhibiting a heightened sense of accountability to the constituencies served for the outcomes created.</li> <li>• Responsible for decisions and outcomes created</li> </ul>	<ul style="list-style-type: none"> <li>• Change agent</li> <li>• Highly accountable</li> <li>• Dedicated</li> <li>• Socially alert</li> </ul>
Brinckerhoff (2009)	A social entrepreneur is someone who takes reasonable risk on behalf of the people their organization serves.	<ul style="list-style-type: none"> <li>• Opinion leader</li> </ul>
Ashoka (2012)	Social entrepreneurs are individuals with innovative solutions to the most important social problem.	<ul style="list-style-type: none"> <li>• Visionary</li> <li>• Committed</li> </ul>

Source: author's adjustment to [25]

From these types of social entrepreneurs, their definitions and characteristics, we can conclude that they create economic and social value through the adoption of balanced decisions with the knowledge of having limited resources. In Croatia, social entrepreneurs are still not recognized as change agents due to shortcomings in the legal and institutional framework, educational programs, political will and financial resources.

## **2.2 Social enterprises**

Social enterprises are hybrid organizations aiming to achieve social (and/or environmental) purposes using legal forms of business [26,27,28]. As non-profit organizations, their primary aim is to achieve a social mission, but at the same time as in traditional companies, their goal is a successful operation on the market [29]. Social enterprises use market strategies to achieve social aims [30]. Social enterprises diverge from traditional enterprises because they have two main goals - to create social and economic value [31,2]. The Strategy for the Development of Social Entrepreneurship in the Republic of Croatia 2015-2020 provides for the first time the criteria for defining social entrepreneurs in Croatia ([32].

- Social entrepreneur achieves a balanced social, environmental and economic goal of business.
- Social entrepreneur is engaged in the production and transport of goods or services or art that generate revenues on the market, and has a favorable impact on the environment, contributes to the development of the local community and society at large.
- Social entrepreneur creates new value and ensures financial sustainability in a way that three years after the establishment of business at least 25% of the income is planned to be or is realized by its entrepreneurial activities.
- Social entrepreneur uses at least 75% of the profit to invest in the development of its activities and the achievement of its primary business objective.
- Social entrepreneur is characterized by voluntary and open membership and a high degree of business autonomy.
- The Republic of Croatia, local and territorial (regional) self-government or a public authority may not be the sole founder of the social enterprise.
- Social entrepreneur is characterized by participatory decision-making process (involvement of stakeholders in transparent and accountable management), or the decision making is not exclusively related to the ownership or membership structure but includes other stakeholders: employees, members, consumers, and other relevant organizations.
- Social entrepreneur monitors and evaluates its social, economic and environmental impact. The results of the evaluation are used in the planning and future steps to increase the impact of the business.
- In the case where social entrepreneur ceases to perform its activity, the assets (apart from the membership fees in cooperatives), after obligations towards creditors are fulfilled and losses from the previous period covered, must be transferred to the ownership of another social enterprise with same or similar goals or to the local community and local (regional) government which will use it for the development of social entrepreneurship.

In 2014 there were 90 entities (social enterprises), while in 2017 in Croatia there were 106 entities. The table shows the diversity of the legal form of social enterprises from which it can be concluded that social entrepreneurship in Croatia offers a variety of solutions that can meet social needs. There are 80 social enterprises that satisfied nine conditions.

**Table 2:** Legal forms of social enterprises in Croatia from 2014 to 2017

Legal form	2014.	2017.
Associations	44	33
Co-operatives	31	45
Institutes	2	2
Private Limited Liability Companies	13	26
IN TOTAL	90	106

Source: Own elaboration of author

### 3. Institutional factors and growth of social enterprises

Identifying business factors in certain sectors is a valuable practice for several reasons. First, it leads to a better understanding of the competitive environment, which in turn can help in making decisions related to new product development and marketing [33]. According to [34] understanding and development of business factors enables enterprises to find a different position among other companies and successfully combine the creation of the expected value with the low cost. Reference [35] distinguish internal and external business factors. Internal business factors refer to the characteristics of the internal environment in enterprises such as products, processes, people, and structures [33]. External business factors relate to the external environment in enterprises. Business factors represent a limited number of areas where satisfactory results will ensure the successful and competitive performance of the individual, department or organization [36].

According to [3] business factors are classified into three categories:

- Individual factors
- Institutional factors
- Organizational factors

According to Sahara [3] business factors described by characteristics of social entrepreneurs are individual business factors, business factors described by organizational characteristics of social enterprises are called organizational business factors and external environmental factors at which social enterprises can not influence are institutional business factors. The success of social enterprises depends on the evolution of commercial and legislative thinking. On the legislative side, incentives for investment, such as partial tax subsidies, encouraging investors to finance social enterprises regarding profit-oriented companies that offer a more compelling yield. One important mission of social enterprise is the mission of recruiting members of social groups engaged in production and service to be sold in the commercial market [37]. In social enterprises, when it comes to growth, the biggest role goes to stakeholders. One of the most important stakeholders in social enterprises are

employees. Increasing the number of employees in social enterprises creates social value for the local community [37] and connecting social values of enterprises can attract new sources of funding. The number of employees is the variable with the lowest volatility, because social entrepreneurs will refrain from hiring or firing employees until they are sure of the changes. The main aim of paper refers to the development, promotion and cooperation of social enterprises with the local community and the public sector. The main research questions that we want to answer in the paper are the following:

RQ 1. Is there cooperation between local communities, public sector, and social enterprises?

RQ 2. What is the availability of sources of funding?

RQ 3. How good is an existing legal framework for social enterprises?

### ***3.1 Cooperation of social enterprises with the local community***

According to [38] social entrepreneurs are aware that they are not able to affect the economic and social changes without networking. Social enterprises are key to strengthening local communities as they economically, socially and politically can respond to the challenges [39] For social entrepreneurs community networks are crucial to ensure that their interventions result in community development and social value creation [40]. Social enterprises experience win-win scenarios by employing communities in their organizations [40]. Reference [41] noted that the role of social entrepreneurs is to discover and create new opportunities through innovation, experimentation and resource mobilization. In local communities, social enterprises seek to build groups that are open to all community members and enable fair distribution of social utility [39]. The task of social enterprises is to mobilize members of the local community to address common problems and enable democratic managing and right to vote in the institutions [39]. Reference [42] state that social enterprises often educate participants, build commitment and establish effective ways of mobilizing resources to empower local communities, and find new ways to access finance and the skills that are necessary for the achievement of social mission. In Croatia the general public perceive social enterprises negatively, as they currently lack visibility, and many institutions and companies remain un-informed about the role and nature of such organizations [43]. Reference [44] argue that building social networks and social connections encourage people to participate in social contexts including local services and other voluntary activities. Trust creation among the subjects is a necessary condition in order to build social capital. Accordingly, social entrepreneurs spend a significant portion of their time building trust among the communities they serve. It also helps them to gain trust from the communities. Reference [44] argue that building social networks and social connections encourage people to participate in social contexts including local services and other voluntary activities.

### ***3.2 Cooperation of social enterprises with public sector***

Reference [20] states that all kinds of government incentives social entrepreneurs see as government assistance in the activities of the common good. The existence of legal, financial and other benefits also means more stimulating environment for social enterprises [20]. Croatia has not built an institutional framework to support the operation and development of social enterprises and one of the main reasons for this is the lack of definition

of the legal framework, but also a wide interpretation and understanding of the concepts of social entrepreneurship and social enterprise, both in theory and in practice [45]. Social Entrepreneurship in Croatia, although recognized by government agencies and ministries as an important form of activity in the community in order to influence the resolution of the economic, social, environmental problems, still indicates needs for legal framework improvement, system construction support and the institutional framework [45]. If we look at the financial benefits, according to [20] among the most important facilitation is certainly exemption from paying income tax for non-profit organizations engaged in economic activities. It is important to recognize that stakeholders should take the lead role in creating an environment that will be supportive for the operation and development of social enterprises and social entrepreneurship in general. According to [46] very important and fast-growing awareness of social entrepreneurship at national, regional, local and educational institutions leads to opportunities for systematic financial support through EU funds and programs.

### **3.3 Sources of funding social enterprises**

According to [23] funding for social enterprises is a sensitive subject and can easily draw attention from social mission, because finance is a major difficulty for social entrepreneurs. This institutional business factor is related to the previous factors because according to [45] the effectiveness of the legislative and institutional framework, the availability of diverse financing sources and the tradition of the main factors affect the funding diversification of social enterprises. According to [20] identified three lines of support for social entrepreneurship in Croatia are government institutions, line ministries or foundations, which distribute funds from the government's budget for different programs; international organizations, providing support in the form of grants to start socially entrepreneurial ventures; actors from the business sector, financial institutions and funds, to ensure financial mechanisms for social entrepreneurial ventures such as investing or micro-credit. Grant funding is very important but the dependence on grants is key barrier to the long-term sustainability and growth of the sector [43].

Many studies show that social entrepreneurs depending on grants have difficulty to ensure expansion capital crucial the longer-term sustainability and growth of social innovations. According to [43] there is no specialized financial institution to support social enterprises, and mainstream financial institutions are reluctant to extend credit to initiatives with low visibility and with an explicit social mission hard to assess under their internal risk rating systems. According to [45] in countries where it is not an adequate legal and institutional framework for the operation of social enterprises as the only sources of funding social enterprises listed donations from international and domestic sources and their own income from activities. In order to achieve social and environmental objectives, social enterprises can apply different strategies - the diversification of income to full financial self-sustainability, reducing costs and maximizing resources and such financial spectrum of social enterprise based on commercial / economic objectives, on the type of business and its maturity [45]. For systems support according to [20] there are two ways of thinking; some believe that programs to encourage social entrepreneurship should be devolved to local, not government, while others believe the opposite. Yet these two currents agree that the support system should consist of: initial capital intended for launch ventures or promotional activities, incentives for employment of special groups and the favorable fiscal system, or tax exemptions.

#### **4. Limitations of the study**

When creating a paper, one of the major problems that arose was the definition of social entrepreneurship. In the Croatia, the concept and meaning of social entrepreneurship is not well known. Social entrepreneurship in the Republic of Croatia does not have a legislatively institutional framework defined, and it is difficult to determine a sample that meets the criteria defined by the Strategy for the Development of Social Entrepreneurship in the Republic of Croatia for the period 2015 to 2020. In the empirical part of the research, measuring scales for variables are not defined for social enterprises, and existing scales related to traditional enterprises are difficult to apply.

#### **5. Methodology**

Reference [47] in 2013 found 95 legal entities that meet the criteria of the Development Strategy of Social Entrepreneurship in Croatia from 2015 to 2020, while that number was reduced to 90 in 2014. Given the criteria for social enterprises, the sample will be 80 owners of social enterprises (data were collected by the Accelerator for Social Entrepreneurs from 2017). The empirical data was conducted on a sample of 50 social entrepreneurs. The empirical data collected were analyzed by multiple regression analysis.

From described institutional business factors the research expects positive influence of all business factors on the growth of social enterprises. According to [48] there is a clear tendency for external sources to have a negative impact on the growth of social enterprises, while according to [49] there is a positive link between external sources and growth of social enterprises. Social enterprises are faced with the problem of the availability of external sources of funding for their further development [50].

The analysis shows that institutional business factors as independent variables Sources of funding and Cooperation with the public sector have a positive effect on the dependent variable Number of employees. T - test of independent variables Source of financing is 2.176 with a significance level of 0.35 ( $p < 0.05$ ) and obtained results show that the independent variable Sources of funding is significant, while the independent variable Cooperation with the public sector in which t-test is 0.555 and the level of significance of 0.581, indicates absence of significance of variable in the model.

The result of the independent variable Sources of financing confirms the theory that positively affect the growth of employees in social enterprises. The result of t-test independent variables Cooperation with the local community refers to the movement of variables in the opposite direction. This result indicates also one new problem; lack of knowledge both for local community and social enterprises.

The state has great power in developing the social enterprise sector and social entrepreneurs, also supporting legislation that simplifies the establishment, implementation and reporting of social enterprise activities. Collaboration with the public sector and local community enables the growth of social enterprises [49].



**Table 3:** Multiple regression analysis of institutional business factors

Model	Unstandardized Coefficients		Standardized Coefficients	T test	Sig.
	B	Std. error	Beta		
(Number of employees)	-12.745	22,936		-, 556	, 581
Local community	-4.113	6.718	-, 103	-, 612	, 543
Sources of funding	9.307	4,277	, 356	2,176	, 035 *
Public sector	2.429	4.375	, 082	, 555	, 581

\* P <0.05 Source: Own elaboration of the author

The coefficient of determination ( $R^2 = 0.114$ ) and the adjusted coefficient of determination ( $R^2 = 0.056$  \*) are very low, which means that the number of employees in social enterprises is explained to small extent by institutional variables. Therefore, according to adjusted coefficient of determination this model explained 5.6% of the variation of the dependent variable.

**Table 4:** The coefficient of determination of institutional business factors

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	, 338a	, 114	, 056	30,122

Source: Own elaboration of the author

## 6. Conclusion

The development of social entrepreneurship in Croatia has been contributed by international organizations which, according to [20] have empowered certain organizations that act as educators, advisors and supporters in the development of social entrepreneurship. Cooperation with the public sector and local community has enormous importance in the approach and the mobilization of funds from different sources. Cooperation of social enterprises with the local community, except fulfilling the needs of society, has advantages in employing and educating both social entrepreneurs and society. Social enterprises in Croatia are facing with several weaknesses and threats that come from internal and external environment. Main weakness that comes from internal environment is the lack of managerial skills and competencies of social entrepreneurs that prevents them from further business development. In local community there is low awareness of the potential of social enterprises as providers of a wide range of general-interest services. This gives us the answer to first research question, that cooperation between social enterprises and local community exist, but people are not aware of social benefit delivered by social enterprises. External environment weaknesses include lack of institutional and legal framework that leads to the lack of appropriate/enabling fiscal framework and legal inconsistencies. Institutional business factors influence the growth of social enterprises measured by number of employees. Source of funding has significant influence on number of employees and access to resources and funding must

be available in different forms at the right time. This is the current problem that must be solved for further growth of social enterprises. It is important to raise awareness of public authorities the potential and specificities of social enterprises. Sustainable and guaranteed sources of funding, new financial instruments for start-ups and for further development, new fiscal frame, and simplified regulatory environment are the key institutional factors that ensure the growth of social enterprises in Croatia. The contribution of research is a framework of institutional business factors that can help social entrepreneurs in the beginning of their social adventure and better understanding of the business environment and theirs empirically examining. Defining the growth of social enterprises (growth indicators) is another contribution of the research. Due to nature of social enterprises, the best growth indicator is number of employees.

## **7. Recommendations**

Results of research can be taken for further studies and it is needed to make the framework of institutional business factors for each social enterprise activity (health care, environmental protection, food and nutrition and others). Further studies should include bigger samples in order to ensure the representativeness of the results.

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